JUN 11 1956
HAROLD B. WILLEY, Clerk

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956.

## No. 156

Elsie W. Faroll, Executor of the Estate of Barnett Faroll, Deceased,

*Petitioner,*

*vs.*

John T. Jarecki, Collector of Internal Revenue,

*Respondent.*

**Petitien for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.**

CLAUDE A. ROTH
SIDNEY U. HIKEN
BERNARD WEISBERG
231 S. LaSalle Street
Chicago 4, Illinois

JOSEPH H. TAYLOR
29 S. LaSalle Street
Chicago 3, Illinois
Counsel for Petitioner

GOTTLIEB AND SCHWARTZ,
Of Counsel.

The Scheffer Press, Inc.—ANdover 3-6850

# INDEX


PAGE

Opinions Below ..... 1

Jurisdiction ..... 2

Question Presented ..... 2

Statute Involved ..... 2

Statement ..... 4

Reasons For Granting The Writ ..... 6

Conclusion ..... 16

Appendix A—Opinion Below ..... 17

Appendix B—Conflicting Opinion ..... 30


CITATIONS.

CASES:


Commissioner v. Boeing, 106 F. 2d 305 (C. A. 9, 1939), cert. den. 308 U. S. 619 (1939) ..... 11

Commissioner v. Burnett, 118 F. 2d 659 (C. A. 5, 1941) 13

Commissioner v. Covington, 120 F. 2d 768 (C. A. 5, 1941), cert. den. 315 U. S. 822 (1942) ..... 11

Commissioner v. Stevens, 78 F. 2d 713 (C. A. 2, 1935) .. 15

Corn Products Refining Co. v. Commissioner, 350 U. S. 46 (1955) ..... 9-10, 12, 13

Gruver v. Commissioner, 1 T. C. 1204 (1943), aff'd. 142 F. 2d 363 (C. A. 4, 1944) ..... 15

Polachek v. Commissioner, 22 T. C. 858 (1954) ..... 10

U. S. v. Chinook Investment Company, 136 F. 2d 984 (C. A. 9, 1943) ..... 7-8, 14

PAGE

United States v. New York Coffee & Sugar Exchange, 263 U. S. 611 (1924) ..... 11-12

Williamson v. Commissioner, 201 F. 2d 564 (C. A. 4, 1953), cert. den. 345 U. S. 970 (1953) ..... 11

STATUTES:

Internal Revenue Code of 1939
Sec. 23 ..... 2-3
Sec. 117 ..... 3, 9-11, 13-15

Internal Revenue Code of 1954
Sec. 1221 ..... 9, 13
Sec. 1233 ..... 13

Revenue Act of 1928, Sec. 22 (c) ..... 13

MISCELLANEOUS:

J. M. Mehl, Futures Trading Under the Commodity Exchange Act 1946-1954 ..... 6

H. Conf. Rep. No. 1385, 73rd Congress, 2nd Session, p. 22, 1 Cum. Bull. (Part 2), 627, 632 (1939) ..... 14

G. C. M. 17322, XV-2 Cum. Bull. 151 (1936) ..... 12

G. C. M. 18658, 2 Cum. Bull. 77 (1937) ..... 13

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1956.

---

**No.**

---

Elsie W. Faroll, Executor of the Estate of Barnett Faroll, Deceased,

*Petitioner,*

*vs.*

John T. Jarecki, Collector of Internal Revenue,

*Respondent.*

---

**Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.**

---

Elsie W. Faroll, Executor of the Estate of Barnett Faroll, Deceased, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit, entered in the above-entitled case on March 15, 1956.

## Opinions Below.

The memorandum opinion, findings of fact and conclusions of law of the District Court are unreported, but are printed in the Record (R. 36-43). The opinion of the Court of Appeals is reported at 231 F.2d 281 and is printed in Appendix A hereto, *infra*, page 17.

## Jurisdiction.

The judgment of the Court of Appeals was entered on March 15, 1956. The jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

## Question Presented.

During 1943 and for many years prior and subsequent thereto, the taxpayer, a member of the Chicago Board of Trade, devoted virtually all of his working time to the purchase and sale on his own account of commodity futures from and to fellow Board of Trade members on the floor of that exchange. During 1943, the taxpayer sustained losses of more than $136,000 in this activity. The question presented is whether the commodity futures which the taxpayer bought and sold were capital assets under Section 117(a) of the Internal Revenue Code of 1939. The taxpayer contends that they were not capital assets and that the above losses are therefore deductible in full from gross income.

## Statute Involved.

Internal Revenue Code of 1939:

> "Sec. 23. Deductions From Gross Income.
>
> In computing net income there shall be allowed as deductions: * * *
>
> (e) Losses by individuals. In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—
>
> (1) if incurred in trade or business; or
>
> (2) if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *

(g) Capital losses.

(1) Limitation. Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117."

"Sec. 117. Capital Gains and Losses.

(a) Definitions. As used in this chapter—

(1) Capital assets. The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(A) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; • • •

(d) Limitation on capital losses. • • •

(2) Other taxpayers. In the case of a taxpayer, other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus the net income of the taxpayer of [or] $1,000, whichever is smaller. For purposes of this paragraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets."

## STATEMENT.[1]

During 1943 and for many years prior thereto and continuously thereafter until his death in January 1954 the taxpayer devoted virtually all of his working time to the purchase and sale for his own account of commodity futures on the Chicago Board of Trade, of which he was a member. Except for vacations, illnesses and trips out of the city he was personally present on the floor of the Board of Trade on each business day for this purpose from the opening hour of 9:30 A.M. until the exchange closed at 2:00 o'clock on week days and 12:00 noon on Saturdays. During 1943 the taxpayer was personally present on the floor of the Board of Trade not less than 248 days. When not on the floor of that exchange, the taxpayer devoted his remaining working time to research and other activities related to his trading on the Board of Trade with the exception of occasional and brief consultations with the members and employees of Faroll Bros., a brokerage firm in which he held a general partnership. Such consultations were limited to important managerial questions and at no time material herein did the taxpayer devote any substantial amount of time to the operations of that partnership.

During the calendar year 1943, the taxpayer entered into more than 10,000 separate purchase and sale transactions in commodity futures on the floor of the Board of Trade. These transactions involved more than 80,000,000 bushels of commodities (chiefly wheat, oats and rye) having a value of more than $84,000,000. On an average day the taxpayer entered into 41 separate transactions,

[1] Barnett Faroll died on January 5, 1954. Thereafter, Elsie W. Faroll, Executor of his estate, was substituted as the Plaintiff in this case. In this petition, the decedent Barnett Faroll is for convenience referred to as the taxpayer.

involving over 325,000 bushels of commodities, having a value of more than $340,000. None of the taxpayer's futures transactions were hedges nor was the taxpayer a farmer, producer, miller, operator of a grain elevator, operator of a grain warehouse or processor in any other manner of grains.

During 1943 the taxpayer sustained a net loss of approximately $136,000 in the above described purchases and sales of commodity futures. The Commissioner of Internal Revenue disallowed this amount as an ordinary deduction from gross income on the ground that the losses in question were capital losses subject to the limitations of Section 117(d)(2) of the Internal Revenue Code of 1939 (R. 31). The taxpayer thereafter paid the income tax deficiency asserted by the Commissioner for 1943 plus interest thereon, and filed a claim for the refund of these amounts with the respondent collector. When six months passed without action on this claim (Section 3772, I. R. C. 1939), this suit for a refund followed in the District Court. The jurisdiction of that court was based on 28 U.S.C. Section 1340. All of the evidence was stipulated and the case submitted on briefs. In a memorandum opinion (R. 36-39), Judge Barnes concluded that the commodity futures which the taxpayer sold in 1943 constituted property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. He thereafter made findings of fact and conclusions of law to that effect and entered a judgment for the taxpayer (R. 39-44). On appeal, a divided panel of the Court of Appeals, Judge Lindley dissenting, reversed the judgment and remanded the case with directions to enter a judgment for the defendant. Speaking for the majority, Circuit Judge Finnegan agreed that the taxpayer's commodity futures constituted property and apparently agreed with

the District Court finding that the taxpayer's buying and selling activity constituted a trade or business under the statute. However, he concluded that these commodity futures were capital assets on the ground that they were held for the speculative "purpose of profiting from uncertain fluctuations in price" rather than for sale to customers. Judge Lindley, dissenting, was of the view that the District Court correctly held that the taxpayer held commodity futures primarily for sale to customers, and that the sales were made in the ordinary course of the taxpayer's trade or business.

**Reasons for Granting the Writ.**

The buying and selling of commodity futures contracts on some 17 regulated commodity exchanges is of major economic importance. By authoritative estimate, the number of transactions in all commodities covered by the Commodity Exchange Act during the period from 1947-1948 through 1953-1954, ranged from 7.1 million to 8.9 million. The value of the commodities involved in these transactions ranged from 32.3 billion dollars to 49.4 billion dollars. In the year ended June 30, 1954, the dollar value of futures trading subject to regulation (42.1 billion) was more than twice the dollar value of all transactions in stocks and bonds on registered securities exchanges.[2]

The Court of Appeals decision singles out an entire class of taxpayers in this sector of the economy—exchange members engaged in the business of buying and selling commodity futures contracts for their own account —and holds that the *business* gains and losses of per-

---

2 The data in the above paragraph are taken from J. M. Mehl, Administrator, Commodity Exchange Authority, Futures Trading Under the Commodity Exchange Act 1946—1954, U. S. Department of Agricuture, Washington, D. C. (1954) pp. 3, 5, 6, 7.

sons within this class are to be taxed at capital rates. This decision should be reviewed by this court because of its general importance, because it conflicts with decisions of other courts of appeal and applicable principles announced by this Court, and because it reflects general confusion and uncertainty concerning the interpretation of the capital asset provisions of the Internal Revenue Codes of 1939 and 1954.

1.

The decision of the Court of Appeals is in conflict with the decision of the Ninth Circuit Court of Appeals in *U. S.* v. *Chinook Investment Company,* 136 F. 2d 984 (1943), printed in Appendix B hereto, *infra,* page 30. The taxpayer in the *Chinook* case was a corporation organized to buy and sell stocks, bonds and other securities. It maintained an office where securities were purchased and sold *when it was thought the market justified.* The taxpayer did not acquire securities for the purpose of investment.[3] The Commissioner, urging capital loss treatment in a refund suit by the taxpayer, denied that the taxpayer's securities were held "primarily for sale to customers in the ordinary course of [its] trade or business", on the ground that the quoted exclusion from the Section 117 definition of capital assets did not extend to securities held by a speculator or investor, however active his trading. The Court of Appeals disagreed with the Commissioner and upheld a District Court finding (similar to that made by the District Court in the instant case) that the property in question was held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. Circuit Judge Healy said,

---

[3] Neither can it be said that the instant taxpayer acquired or held commodity futures contracts for investment purposes since neither dividends nor interest are paid on such property.

"There is an element of investment as well as an unavoidable element of speculation in every business in which property, whether tangible or intangible, is regularly bought and sold. The 'in-and-out' market hanger-on who buys and sells through brokers on margin is a typical example of the pure speculator in stocks. *Cf. Commissioner* v. *Burnett*, 5 Cir., 118 F. 2d 659. On the other hand, an investor is ordinarily thought to be a person who acquires property for the income it will yield rather than for the profit he hopes to obtain on a resale. Appellee appears to belong less in either of these categories than in the category of a dealer. While it dealt in intangibles associated in the popular mind with speculation or investment, nevertheless it carried on a regular business roughly comparable with that of a dealer in hogs or cattle or town lots, finding its customers where it could."

The Court of Appeals in the instant case attempted to distinguish *Chinook* and at the same time acknowledged disagreement with it. We submit that the factual differences between *Chinook* and the instant case are not significant. The respective courts of appeal are squarely in disagreement on the question of whether property held by a taxpayer (be it securities or commodity futures) not for investment, but for the purpose of profiting from anticipated changes in market price and in the course of the taxpayer's trade or business, can come within the statutory description of property held for sale to customers. Plainly, the taxpayer in this case would have prevailed before the court which decided *Chinook*.[4]

---

4 We respectfully submit that Judge Finnegan erred in stating that statutes, regulations and case law concerning stock brokers, dealers, speculators and investors have changed since the **Chinook** case. Since no references are given, we cannot determine what this statement was intended to describe. No such suggestion was made by the government either in the Court of Appeals or the District Court and taxpayer's counsel are not aware of any changes of the type referred to by Judge Finnegan which distinguish the **Chinook** decision from the instant case.

2.

The decision of the Court of Appeals is contrary to the principles announced by this Court in *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46 (1955). In *Corn Products*, this Court restated the principles which should be followed in interpreting the statutory definition of capital assets contained in Section 117 of the Internal Revenue Code of 1939 and which was carried forward unchanged in Section 1221 of the Internal Revenue Code of 1954. Justice Clark's opinion stated:

> ". . . [t]he capital asset provision of § 117 must not be so broadly applied as to defeat rather than further the purpose of Congress. *Burnet* v. *Harmel*, 287 U.S. 103, 108, 77 L ed 199, 204, 53 S Ct 74. *Congress intended that profits and losses arising from the every-day operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by* § 117 *applies to transactions in property which are not the normal source of business income.* It was intended 'to relieve the taxpayer from excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions'. *Burnet* v. *Harmel*, 287 U.S., at 106. Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose. This Court has always construed narrowly the term 'capital assets' in § 17. See *Hort* v. *Commissioner*, 313 U. S. 28, 31, 85 L ed 1168, 1171, 61 S. Ct. 757; *Kieselbach* v. *Commissioner*, 317 U.S. 399, 403, 87 L ed 358, 361, 63 S. Ct. 303." (emphasis added).

The *Corn Products* decision, in order to further the purpose of Congress, treated the taxpayer's commodity futures as non-capital assets, even though they did not fall

within any of the exclusions contained in Section 117. By contrast, the taxpayer in the instant case was given capital asset treatment despite the fact that the commodity futures in which he deal come squarely and literally within the Section 117 exclusion of property held primarily for sale to customers in the ordinary course of his trade or business. Moreover, this result is plainly contrary to the legislative intention, as described in *Corn Products,* that "profits and losses arising from every-day operations of a business be considered as ordinary income or loss rather than capital gain or loss."

The principle involved is of basic and continuing importance in the interpretation and administration of the revenue laws. This Court should clarify the confusion and uncertainty created by the lower court's misreading of the *Corn Products* case.

3.

There is a compelling need for this Court to clarify the considerable confusion and uncertainty existing under applicable decisions relating to the taxation of commodity futures transactions and the interpretation of the statutory definition of capital assets. In what follows some aspects of this confusion and uncertainty are mentioned.

The decision of the Court of Appeals and other commodity futures cases[5] ignore and are in conflict with the frequently stated rule that the established criteria for determining whether property is held by a taxpayer for sale to customers in the ordinary course of his trade or business are "the number and proximity of the purchases and sales to one another . . . and the frequency and continuity of the transactions claimed to result in a trade or busi-

---

[5] See, **e.g., Polachek v. Commissioner,** 22 T.C. 858 (1954).

ness."[6] Under this rule the commodity futures in which the taxpayer dealt clearly were not capital assets. Indeed, it is hard to imagine how the taxpayer's purchase and sales transactions could have been more frequent and continuous. This so-called 'frequency and continuity' test is followed in numerous Court of Appeals decisions and is urged by the Commissioner himself in cases involving the status of other types of property (notably real estate) under the Section 117 exclusion of property held for sale to customers. However, the statute provides no justification for the courts or the Commissioner in following the 'frequency and continuity' test in cases involving other types of property but refusing to concede its applicability to the business of buying and selling commodity futures.

Some of the cases which have considered the taxation of commodity futures transactions[7] and which have treated commodity futures as capital assets, unless they involved hedging, relied on dicta in *United States* v. *New York Coffee & Sugar Exchange*, 263 U. S. 611 (1924). The *Coffee Exchange* case, an unrelated anti-trust case, characterized persons who deal in futures as "hedgers", "legitimate capitalists" and "speculators".[8] However, these la-

---

[6] **Williamson v. Commissioner,** 201 F. 2d 564, 567 (C.A. 4, 1953), cert. den. 345 U.S. 970 (1953). See also **Commissioner v. Boeing,** 106 F. 2d 305, 309, 310 (C.A. 9, 1939), cert. den. 308 U.S. 619 (1939).

[7] See, **e.g.,** the dicta in Circuit Judges Holmes' concurring opinion in **Commisoner v. Covington,** 120 F. 2d 768, 771, 772 (C.A. 5, 1941), cert. den. 315 U.S. 822 (1942), dicta which the majority below relied on in labeling the instant taxpayer a "trader".

[8] "Those who deal in 'futures' are divided into three classes: First, those who use them to hedge, **i.e.,** to insure themselves against loss by unfavorable changes in price at the time of actual delivery of what they have to sell or buy in their business; second, legitimate capitalists, who, exer-

bels, as this Court recognized in the *Corn Products* case, are manifestly inadequate as guides to the proper tax treatment of commodity futures transactions.

Other commodity futures cases have mistakenly relied upon a dictum in a general counsel's memorandum, one aspect of which this Court discussed in *Corn Products*, G. C. M. 17322, XV-2 Cum. Bull. 151 (1936). As the *Corn Products* opinion pointed out, this Treasury ruling took the position that cotton futures involved in hedging transactions were non-capital assets and that gains and losses therefrom should be taxed at ordinary rates; in addition, this position was upheld by a series of judicial and administrative decisions, while successive reenactments of the Internal Revenue Code left it unchanged. Finally, the 1954 Code specifically recognized the propriety of this tax treatment of hedging transactions.

Virtually all of G. C. M. 17322 dealt with hedging transactions. However, in the last paragraph of this memorandum the statement was made that futures contracts which are "speculative" would be given capital asset treatment. No attempt was made to define speculation or justify the use of this concept in interpreting Section 117.

To label a taxpayer's business as "speculation" obscures the proper inquiry under the statutory definition of capital assets. And it solves no problems since all business men who buy property for resale assume the risk of price fluctuations. Unlike the position on hedging, the unsupported assertions in G. C. M. 17322 relating to "speculative" dealings in commodity futures are not buttressed by their subsequent administrative, judicial and

---

8 (Continued)

cising their judgment as to the conditions, purchase or sell for future delivery with a view to profit based on the law of supply and demand; and, third, gamblers, or irresponsible speculators who buy or sell as upon the turn of a card." 263 U.S. at 619.

legislative history and were not involved or upheld in *Corn Products*. One year after this ruling was issued, the Bureau, in G. C. M. 18658, 2 Cum. Bull. 77 (1937), inconsistently sanctioned the taxation at ordinary rates of the gains and losses of taxpayers who buy and sell "straddle" positions in commodity futures on contract exchanges. This ruling recognized that the purchase and sale of commodities is an income-producing factor to such taxpayers and that their position was similar to that of dealers (although, like the taxpayer in the instant case, they clearly dealt in futures contracts for the purpose of profiting from price fluctuations and were not necessarily engaged in any allied business). Moreover, the same Section 1233 (a) of the 1954 Code which was cited in *Corn Products* as recognizing the hedging exception, indicates clearly that commodity futures which are not hedges may nevertheless be non-capital assets.[9]

Yet other cases have erroneously treated commodity futures as capital assets, relying on regulations relating to the right of securities brokers to inventory securities bought for their own account, pursuant to Section 22 (c) of the 1928 Revenue Act and its statutory successors.[10]

---

[9] Internal Revenue Code of 1954:

"Sec. 1233. Gains and Losses From Short Sales.

(a) Capital assets.—For purposes of this subtitle, gain or loss from the short sale of property other than a hedging transaction in commodity futures, shall be considered as gain or loss from the sale or exchange of a capital asset to the extent that the property, including a commodity future, used to close the short sale constitutes a capital asset in the hands of the taxpayer."

Since the Section 117 definition of capital assets was carried forward unchanged in Section 1221 of the 1954 Code, the reference to the tax status of commodity futures contained in Section 1233 must be taken as declaratory of pre-existing law under the 1939 Code.

[10] See **e.g., Commissioner v. Burnett**, 118 F. 2d 659 (C.A. 5, 1941).

These regulations hold that only securities "dealers" may use inventories, define a "dealer" as a "merchant", state that "speculators" are not "merchants", and hold that "speculators" are therefore not entitled to inventory securities on hand. This line of authority has no bearing on the status of property under Section 117. This is precisely what the Ninth Circuit Court of Appeals held in the *Chinook* case. Moreover, it should be noted that since commodity futures are not and cannot be merchandised in the same way as securities, the effect of relying on these regulations is to make commodity futures *per se* capital assets. Again, the result is discriminatory treatment of taxpayers who deal in one particular type of property, without any economic or statutory basis for such discrimination.

The only justification ever advanced by the Commissioner for taxing at capital rates what are regarded as speculative gains and losses, even though they arise from a taxpayer's trade or business, is an ambiguous excerpt from the legislative history of a 1934 amendment to the definition of capital assets. This amendment added the words, "to customers" and "ordinary" to the exclusion of property held by a taxpayer primarily for sale to customers in the ordinary course of his trade or business. The amendment was for the stated purpose of "making it impossible to contend that a stock speculator trading on his own account is not subject to the provisions of section 117." H. Conf. Rep. No. 1385, 73rd Congress, 2nd Session, p. 22, 1 Cum. Bull Part. 2), 627, 632 (1939). We submit that when the background and legislative history of this amendment are analyzed in detail (which we intend to do if review is granted by this Court) it will become apparent that they afford no justification whatever for the arbitrary and unreasonable discrimination contended for by the Commissioner in this case.

Each of the elements of the relevant statutory exclusion is present in this case. (1) Despite Judge Finnegan's suggestion that the record contains no evidence that the taxpayer intended making or accepting delivery of a commodity upon the expiration of a future and his attempt to distinguish the taxpayer's transactions from the commodities themselves, neither the government nor the Court of Appeals majority denied that these commodity futures constituted "property", for purposes of Section 117. Otherwise, they would fall outside the definition of capital assets in the first instance. (2) They were held primarily for sale. There was nothing else the taxpayer could do with them since he was not engaged in any allied business which required the consumption or processing of grains. The Court of Appeals' novel theory that where a taxpayer's business involves holding property for the purpose of profiting from anticipated price changes, then the statutory requirement that property be held "primarily for sale" is not met, is manifestly unsound. Literally applied, it would give capital asset status to all property dealt in for profit since, ordinarily, the profit motive of a business man who deals in property outweighs such incidental purposes as making sales in order to realize profits and losses. (3) Although Judge Finnegan stated that the sales to other exchange members were not sales to "customers", he gave no reasons for this conclusion. In reaching it, he ignored the common sense meaning of that term as well as authority under which the other members of a securities exchange have been held to be the customers of an exchange member selling for his own account. See, *e.g.*, *Commissioner* v. *Stevens*, 78 F. 2d 713 (C. A. 2, 1935). See also *Gruver* v. *Commissioner*, 1 T. C. 1204, 1207 (1943), aff'd 142 F. 2d 363, 367 (C. A. 4, 1944). (4) Finally, that the tax-

payer's buying and selling of commodity futures constituted a "trade or business" under the statute, as found by the District Court, seems to have been conceded by the Court of Appeals.

The decision below entitles an entire class of taxpayers to preferential taxation on their business profits and places special limitations on the deduction of their business losses, even though these profits and losses arise from their day-to-day income-producing activity. This result is reached because and only because these taxpayers happen to seek their livelihood by engaging in the business of buying and selling one type of property—commodity futures contracts. The questions of statutory interpretation and taxation equity raised in this case are of general importance and should be decided by this Court.

## CONCLUSION.

For the foregoing reasons this petition for a writ of certiorari should be granted.

Respectfully submitted,

Claude A. Roth
Sidney U. Hiken
Bernard Weisberg
231 S. LaSalle Street
Chicago 4, Illinois

Joseph H. Taylor
29 S. LaSalle Street
Chicago 3, Illinois
*Counsel for Petitioner*

Gottlieb and Schwartz,
*Of Counsel.*

Dated June 8, 1956.

## APPENDIX A.

IN THE UNITED STATES COURT OF APPEALS
For the Seventh Circuit

No. 11542. OCTOBER TERM, 1955, JANUARY SESSION, 1956.

ELSIE W. FAROLL, Executor of the Estate of BARNETT FAROLL, deceased,
*Plaintiff-Appellee,*
*vs.*
JOHN T. JARECKI, Collector of Internal Revenue,
*Defendant-Appellant.*

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

March 15, 1956.

Before FINNEGAN, LINDLEY and SCHNACKENBERG, *Circuit Judges.*

FINNEGAN, *Circuit Judge.* A judgment of the District Court, in substance, grounded on a finding that commodity futures, sold by the taxpayer, Barnett Faroll,[1] during the year 1943 constituted property held by him primarily for sale (and that sales were made) to customers in the ordinary course of his trade or business, is appealed by the defendant, Collector of Internal Revenue. After that finding, the district judge further concluded that those commodity futures were not "by express statutory definition,

[1] Barnett Faroll died on January 5, 1954. Elsie W. Faroll, his executor, was substituted as the plaintiff in this case. For convenience we refer to the plaintiff's side of the appeal interchangeably as the "taxpayer" or "plaintiff" or "Faroll."

'capital assets,'" citing § 117(a)(1), Internal Revenue Code of 1939,[2] as amended by § 115(b), Internal Revenue Act of 1941, c. 412, 55 Stat. 687, and § 151(a), Internal Revenue Act of 1942, c. 619, 56 Stat. 798. Consequently taxpayer's losses sustained in 1943 on these commodity future sales were not capital losses, according to the court below, and were not subject to the capital loss limitations appearing in § 117(d)(2), Internal Revenue Code of 1939, as amended by § 150(c), Revenue Act of 1942. The losses, aggregating $136,421.59, were allowed in full as an ordinary deduction from taxpayer's gross income under § 23 (e), Internal Revenue Code of 1939. Taxpayer's claim of refund, $43,565.83 plus interest, for federal income taxes erroneously and illegally collected was allowed under the judgment brought here for review.

Stipulated facts underlie the memorandum, findings of fact and conclusions of law made and entered by the district judge. Because of Rule 52(a), Federal Rules of Civil Procedure, 28 U.S.C.A., it is necessary to underscore the prefactory portion of the stipulation:

> " . . . it is expressly agreed that by the use herein of words and phrases such as 'traded in,' 'dealt in,' 'sold for his own account,' etc., the defendant does not concede that the commodity futures which the defendant sold in 1943 were, and the plaintiff does not concede

---

[2] "§ 117. Capital gains and losses—(a) Definitions. As used in this chapter—

(1) Capital assets.

The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include . . .

(A) stock in trade of taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business . . . "

> that they were not, the decedent's stock in trade or property of a kind which should have been included in an inventory at the close of said year, or property held by him primarily for sale to customers in the ordinary course of his trade or business." [3]

With that caveat in the stipulation of facts, the status, taxwise, of commodity futures and taxpayer's activities were left open for judicial interpretation of the relevant Code provision, and we are not bound to an affirmance. *Chandler* v. *Jarecki,* 226 F. 2d 403 (7th Cir. 1955).

This case is the converse of those familiar instances when taxpayers insist upon capital gain treatment for their transactions. Here, the defendant government seeks the capital asset status under the Code, and taxpayer resists. In this respect, as well as others, the appeal before us is unlike the taxpayer's claim for capital-asset treatment under § 117(a) of the Internal Revenue Code of 1939, in *Corn Products Co.* v. *Commissioner,* 350 U.S. 46 (1955), of which the plaintiff, before us, places her chief reliance. But a more significant element of Faroll's case in contrast with *Corn Products,* can be shortly stated. "None of the taxpayer's (Faroll's) futures transations referred to in this stipulation were hedges or entered into by him for the purpose of hedging; nor was the taxpayer a farmer, producer, miller, operator of a gain elevator, operator of a grain warehouse, or processor in any other manner in grains." [4] But this phase of the parties stipulation, before us, quickly cuts ground from under the *Corn Products* opinion as a closely analogous precedent. For there, Corn Products, futilely contended that its transactions "did not constitute 'true hedging.'" Such argument being necessary to implement the capital asset position asserted, by

[3] T. R. 14.
[4] T. R. 17.

Corn Products, and, no doubt, because GCM 17322 draws a line of demarcation between speculative transactions in commodity futures and hedging transactions. Rejecting the assertions of Corn Products, Mr. Justice Clark, delivering the Court's opinion said,[5] *inter alia:* "The interpretation outlined in this memorandum has been consistently followed by the courts as well as the Commissioner. While it is true that this Court has not passed on its validity it has been well recognized for 20 years, and Congress has made no change though the Code has been re-enacted on three subsequent occasions. This bespeaks congressional approval. *Helvering* v. *Winmill*, 305 U.S. 79, 83. Furthermore, Congress has since specifically recognized the hedging exception here under consideration in the short sale rule of § 1233(a) of the 1954 Code. We believe that the statute clearly refutes the contention of Corn Products. . . . To hold otherwise would permit those engaged in hedging transactions to transmute ordinary income into capital gain at will . . . " 350 U.S. 46, 53-54 (1955). Consistent with the recitation already quoted from Faroll's stipulation, the district judge, in Faroll's case, repeated that non-hedging element in his memorandum and third finding of fact.

After close examination of the factual situation reported in the *Corn Products*[6] opinion *supra*, we think that case is not decisive of the one before us. Both the Tax Court

---

[5] Footnotes of the Court are omitted in the passage we have quoted.

[6] The grant of certiorari was limited to two questions, one of which, relevant here was: "1. Are transactions in commodity futures, which are not 'true hedges' capital asset transactions and thus subject to the limitations of Section 117 of the Internal Revenue Code of 1939, or do the resulting gains and losses from such transactions give rise to ordinary income and ordinary deductions?" 350 U.S. 46 at 47.

But it is to be remembered that the court found hedging was present and within the exclusion of § 117(a).

and Court of Appeals found Corn Products' futures transactions "to be an *integral part of its business* designed to protect its manufacturing operations against a price increase in its principal raw material and to assure a ready supply for future manufacturing requirements." (our emphasis). The Supreme Court refused to disturb those findings and rejected, as being without merit, the theory sponsored by Corn Products that its futures were property entitled to § 117 treatment because as such, those futures activities of Corn Products were separate and apart from its manufacturing operation.

As we read that opinion, Corn Products was a manufacturer of products made from grain corn (it manufactures starch, syrup, sugar, and their by-products, feeds and oil) who purchased and acquired its raw materials (indispensable for its manufacturing operations) through commodity futures. The short of it is cogently stated by Mr. Justice Clark: " . . . it is difficult to imagine a program more closely geared to a company's manufacturing enterprise or more important to its successful operation." 350 U.S. 46, 50. Moreover, the Justice referred to specific evidence elicited from officers of Corn Products who testified that in entering the market the company was " 'trying to protect a part of [its] manufacturing costs' . . . to fill an actual 'need for the quantity of corn [bought] . . . in order to cover what [products] we expected to market over a period of fifteen or eighteen months.' " 350 U.S. 46, 51. Justice Clark characterized that testimony as "not the talk of the capital invester but of the farsighted manufacturer." *ibid.* It was, accordingly, held that the futures did not constitute capital assets in Corn Products' hands. We think this is important because the Corn Products case must be read as applicable to the core business of manufacturing in which that taxpayer engaged. That and

the hedging aspect, we think, is what controlled the classification of the futures there involved. The Supreme Court declined to separate out the element of commodity futures. But there is no such indistinguishable fusion of activities present in the appeal we are considering.

After making some particular findings of fact, the district judge added this one: "5 incorporated herein by specific reference thereto *are all of those facts* not hereinabove set forth which are contained in the written stipulation of facts and in the exhibits attached thereto." For that reason we will first report the salient findings of fact, made below, then implement them with pertinent passages from the stipulation:

*Findings:*

> "Throughout 1943 and for many years both prior and subsequent thereto the Taxpayer was engaged in two distinct and separate businesses, as follows: (a) He was a general partner in a brokerage firm and (b) he bought and sold commodity futures, chiefly wheat, corn, oats, barley, rye and soybeans, on the floor of the Board of Trade of the City of Chicago, of which he was in 1943 and thereafter, and since 1907 had been, a member. *His futures transactions were on his own behalf and not for the account of the partnership of which he was a member or for any of the customers of said partnership.* Each week-day during 1943 the Chicago Board of Trade (hereinafter sometimes called the 'Exchange') opened at 9:30 A. M. and closed at 2 P. M. On Saturdays it was open from 9:30 A. M. to noon. Except for vacations, illnesses and trips out of the city, the Taxpayer was personally present on the floor of the Exchange on each day the Exchange was open, during all of the hours it was open, for the sole purpose of buying and selling commodity futures on his own behalf. When not on the floor of the Exchange, he devoted his remaining working time to research

and other activities related to his tradings or dealings on the Exchange except for occasional and brief consultations with the partners and employees of his partnership concerning the brokerage business of that firm. Such consultations were limited to important managerial questions and at no time during 1943 or at any other time material hereto did the Taxpayer devote any substantial amount of time to the operations of the partnership of which he was a member. The *Taxpayer did not buy or sell commodity futures as hedges nor was the Taxpayer a farmer, producer, miller, operator of a grain elevator or warehouse, or a processor in any other manner of grains.* The Taxpayer was personally present on the floor of the Exchange, buying and selling commodity futures, as aforesaid, not less than 248 of the days on which the Exchange was open for business during the year 1943.

"During 1943 the Taxpayer, in more than 10,000 separate transactions, personally bought and sold as the principal, on his own account, commodity futures involving almost 81,000,000 bushels of grain at prices amounting, in the aggregate, to more than $84,000,000. He averaged, at a minimum, 41 separate transactions, over 360,000 bushels of grain and over $340,000 of commitments per day. The only persons permitted to buy and sell commodity futures on the floor of the Exchange in 1943 and both prior and subsequent thereto were members thereof. Therefore, the Taxpayer made all of his commodity future purchases from other members of the Exchange and he made all of his sales of commodity futures to other members of the Exchange."

*Stipulation:*

"The Board of Trade of the City of Chicago is an incorporated association which (a) provides a place, in Chicago, in which grains (as well as certain other commodities and products) are bought and sold, and (b) furnishes and enforces rules and regulations for the making of such purchases and sales. Transactions

on the Board of Trade consist of (a) cash transactions and (b) contracts for future delivery, called 'futures'. Cash grain trading takes place at long rows of tables lining one wall of the trading floor. It involves the purchases and sales, for immediate delivery, of grains already in or shortly to arrive in Chicago. Futures are contracts to deliver or to receive a specified quantity of a particular grain during a specified period of time in the future, which contracts, under the provisions of the Commodity Exchange Act and the regulations duly promulgated thereunder, are made and executed according to the rules and regulations of the Board of Trade. All futures bought and sold on the floor of the Board of Trade are settled through a cen[t]ral agency known as the Board of Trade Clearing Corporation. The transactions on the Chicago Board of Trade for future delivery are made in a structure called a 'pit' which is built upon the trading floor. This pit consists of a number of steps or stairs arranged in such a way that the members of the Board of Trade can stand upon them facing one another in a circle. There are individual pits for each of the principal grains dealt in. At these pits several hundred men gather each morning, awaiting the stroke of a bell, which opens the trading session for that day. Because individual voices are sometimes lost in general shouting, a system of trading by hand signs is used. As soon as a futures transaction is made it is recorded on cards carried by the two parties to the transaction, each party's card bearing his own name at the top. One side of the card is printed in blue and is for recording purchases; the other side is printed in red, and is for sales. The information entered on each card includes, in abbreviated form, the quantity and kind of grain bought or sold, the delivery month, the price at which the trade was made, and the name of the party from whom it was bought or to whom it was sold. Thus, the two cards record a contract between the parties thereto, and such contracts are binding to the same extent as though a formal agreement

had been drawn up, signed and attested by witnesses. Only members of the Chicago Board of Trade are permitted to buy and sell either cash grains or futures on the floor of the exchange. Therefore all purchases, whether of cash grains or of futures, are made by one member from another member, and all sales by one member to another member. However, each member of the Board of Trade may buy and sell either for his own account or as an agent or broker for a non-member.

"All of the foregoing obtained throughout the year 1943 and for many years prior thereto. . . . [stipulation concerning the Charter of the Board of Trade, its Rules and Regulations applicable to 1943 and contained in an incorporated Exhibit.] . . .

"The taxpayer was not at any time during the year 1943 a member of the Board of Trade Clearing Corporation. The partnership of Faroll Bros. was a member of said Board of Trade Clearing Corporation during the year 1943; the taxpayer had authority from said partnership, in which he had a seventy per cent (70%) interest as a general partner, to clear all trades made by him on his own account, as aforesaid, on the floor of the exchange through said partnership during 1943; said permission was in compliance with the rules of the Board of Trade and the by-laws of the Board of Trade Clearing Corporation; and the taxpayer did in fact clear all of his trades during the year 1943 through said partnership.

"All of the taxpayer's dealings on the Board of Trade during the year 1943 were made in compliance with the Rules and Regulations of the Board of Trade and as otherwise described herein. . . . "

With the *Corn Products* opinion as a springboard, Faroll insists his faithful, virtually undivided, efforts devoted to commodity futures transactions constitute § 117(a)(1) "business" during which he held property (commodity

futures) for sale to customers in the ordinary course of his trade or business. Here, this taxpayer is trying to fit the exchanging of cards, resulting in contracts between Board of Trade members, acting in response to price fluctuations, into the statutory words of exclusion. He can do so only by emptying § 117(a)(1) of its contents. This is apparent for several reasons. Reference to Hoffman, Future Trading Upon Organized Commodity Markets In The United States, at page 118, cited as an authority by the Supreme Court in its first marginal note to *Corn Products Co.* v. *Commissioner*, 350 U. S. 46, 47 (1955), shows that the expanded definition of a commodity future, according to Hoffman is: ". . . an agreement to buy or sell, in accordance with law and the rules of an exchange, a definite quantity of a commodity at an agreed price at a future date, being entered into for the purpose of speculating on or hedging against price changes, and being usually closed out later by another offsetting future trade." We think it clear from the record before us that absent hedging, Faroll was a trader. *Commissioner* v. *Covington*, 120 F. 2d 768, 771 (5th Cir. 1941). It should be noticed that fragments of the foregoing definition appear among the facts stipulated.

From the stipulated activities and description of the Board of Trade's operations, we would have to ignore the realities of the market place, to hold otherwise than that Faroll's losses resulted from declines and advances in prices in the market, Chicago Board of Trade, where he daily bought and sold commodity futures on his own behalf.[7] To say all businesses contain an element of specula-

[7] See e.g. the Commodity Exchange Act, 42 Stat. 998, 49 Stat. 1491, as amended for an overview of legislative declaration of policy.

tion is not an answer here. Life itself is a speculation. We also think the inter-member[8] transactions in commodity futures operating in the "pit" are not, on these facts, sales to customers within the meaning of § 117(a)(1). Even capital assets, uncontroverted in such classification, may be sold to a customer or customers without losing preferential treatment under the Code. Indeed, frequently, that is the tax-wise juncture of realization to the holder of such assets.

We find no evidence, in the stipulation and exhibits establishing that Faroll intended making or accepting delivery of a commodity upon the expiration of a future. See *e.g. Chicago Board of Trade* v. *Olsen*, 262 U. S. 1 (1923). *United States* v. *Chinook Investment Co.*, 136 F. 2d 984 (9th Cir. 1943) from which this taxpayer derives much comfort, is estranged from the facts at bar. Chinook, an Oregon corporation, bought and sold securities and generally solicited customers to buy and sell—"the transactions were not on margin, but for cash, and there was a capital turn-over about once a year" ibid. If we follow the Ninth Circuit's suggestion of looking to the status of the assets rather than the status of Faroll, as he would have us, then we point out that Chinook's securities were held for sale to customers under the trial court's findings. Moreover, it was also found that the securities were not held by

---

[8] In taxpayer's brief at page 10, counsel stated:

"The taxpayer sold to persons who 'regularly, customarily, and repeatedly' made purchases **from** him, viz. other members of the Board of Trade. He sold to them and only to them. **They were his customers if only because under the rules of the Board of Trade and the Commodity Exchange Act he could not** sell his commodity futures to any one else, See Board of Trade Rule 259 Pl. E. G. p. 267: 7 U.S.C.A. sec. 2, 6, 6e and 6h. . . . " (The word **"viz"** is emphasized by plaintiff, all other emphasis has been added.)

Chinook for investment or speculation. But such reasoning is fallacious since an asset can be held for speculative purposes and for customers, *i.e.*, to speculate with other customers. We also note that statutes, regulations, and case-law concerning stock brokers, dealers, speculators, and investors has changed since the *Chinook* case.

It is evident, and undisputed, that Faroll's transactions were not in the commodity itself. This significant aspect is also brought into further sharp relief by Hoffman's statement: "Future contracts should . . . be thought of as *rights* to the commodity rather than the commodity itself and in dealing in futures one is dealing not in the actual commodity but in *claims* on or *contracts* for the commodity." Hoffman, Future Trading 111 (1932). We are aware that Mr. Justice Holmes, speaking for the majority in *Board of Trade* v. *Christie Grain & Stock Co.*, 198 U. S. 236, 50 (1905), where the legality of commodity futures trading was in issue, said: "A set-off is in legal effect a delivey. We speak only of the contracts made in the pits because in them the members are principals." Here our concern is not with legality of Faroll's transactions but rather the relations which commodity futures contracts bear to transactions in the actual commodity. *Christie* describes some of the activities at the Board of Trade, federal income tax law was not there involved.

*Corn Products* v. *Commissioner*, 350 U. S. 46, (1955) seems to enlarge the scope of the exclusionary clause in § 117 in policy fashion. For the Court had already pointed out in its opinion: "Admittedly, petitioner's corn futures do not come within the literal language of the exclusions set out in that section [§ 117(a)]. They were not stock in trade, actual inventory, property held for sale to customers or depreciable property used in trade or busi-

ness." 350 U. S. 46, 51-52 (1955). Yet, despite the reflection of Congressional intent described in *Corn Products* we think that the opinion is limited to hedging transactions. At least we are not persuaded that the decision encompasses Faroll's assumption of risk in dealing in commodity futures for the purpose of profiting from uncertain fluctuation in price. Just as any other possessor of a capital asset, Faroll owned property (here a claim or contract right), but these commodity futures were held by him primarily for price fluctuations—the buying and selling followed.

The judgment appealed is reversed and remanded with directions to enter a judgment in favor of the defendant.

REVERSED AND REMANDED.

LINDLEY, dissenting. I am sorry that, after a careful review of the evidence, I feel impelled to dissent from the decision that the judgment be reversed. Without reitration or enlargement, I think that the district court properly analyzed the situation and correctly held that the commodity futures which the taxpayer sold are not to be distinguished from actual commodities; that these futures were held by the taxpayer primarily for sale to customers, and that the sales were made in the ordinary course of the taxpayer's trade or business.

Accordingly, I would affirm the judgment.

A true Copy:
Teste:

.....

*Clerk of the United States Court of Appeals for the Seventh Circuit.*

## APPENDIX B.

### UNITED STATES v. CHINOOK INV. CO.

**No. 10324.**

Circuit Court of Appeals, Ninth Circuit.

July 9, 1943.

Appeal from the District Court of the United States for the District of Oregon; Claude McColloch, Judge.

Action by Chinook Investment Company against United States of America to recover undistributed profits taxes paid under protest. From a judgment for plaintiff, the defendant appeals.

Judgment affirmed.

Samuel O. Clark, Jr., Asst. U. S. Atty. Gen. Sewall Key, Willard H. Pedrick, and Helen Goodner, Sp. Assts. to Atty. Gen., and Carl C. Donaugh, U. S. Atty., and James H. Hazlett, Ast. U. S. Atty., both of Portland, Or., for appellant.

S. J. Bischoff and Robert T. Jacob, both of Portland, Or., for appellee.

Before GARRECHT, HANEY, and HEALY, Circuit Judges.

HEALY, Circuit Judge.

The primary question here is whether losses sustained by appellee taxpayer in the years 1936 and 1937 were losses from the sale of "capital assets," as that term is defined in § 117(b) of the Revenue Act of 1936, 26 U.S.C.A. Int. Rev. Acts, page 874.

Appellee was organized under the laws of Oregon "to own, buy, sell, or to acquire by sale, trade or exchange," bonds, stocks and other securities, and to exercise while

the owner thereof all the rights a natural person would have in the premises. For many years it regularly followed that calling, maintaining an office for the transaction of its business and buying and selling upwards of $300,000 worth of securities yearly. Its management kept in close touch with the market, subscribed to financial periodicals, and bought and sold securities at private sale, "at random," "over the counter," and "listed securities." Unlisted securities dealt in were sometimes those of local companies with whose business the taxpayer was familiar. Purchases were often made direct from the owners of stock, and taxpayer was frequently approached by brokers who had securities to buy or sell. Persons or concerns believed to be interested in making sales or purchases were solicited, and securities were bought or sold when it was thought the market justified. The transactions were not on margin, but for cash, and there was a capital turn-over about once each year. In the acquisition of securities, "investment was not the idea of the Company."

In the years in question appellee sustained losses as the result of which no net profits were realized in the business. The Commissioner assessed a deficiency for 1936 as a surtax on undistributed profits, and for 1937 assessed a deficiency as a personal holding company tax on undistributed profits, claiming that the losses were on sales of capital assets, hence were deductible only to the extent of $2,000 for each year. Appellee paid the assessments and brought suit for refund, recovering judgment for the amount of its claims.

Section 117(b) of the 1936 Act defines capital assets thus: "For the purposes of this title, 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade

of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, *or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.*" [Emphasis supplied.]

The court found that during the tax years appellee was regularly engaged in the business of buying and selling stocks and bonds, and that the securities dealt in were held primarily for sale to customers in the ordinary course of the taxpayer's business, and not for investment or speculation. The Commissioner contends that the finding is not supported by the evidence. More specifically, he argues that the securities bought and sold were held by the taxpayer for investment or speculation. He says that the exception in § 117(b) of "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business" does not extend to securities held by a spectator or investor, however active his trading. The Commissioner relies on Art. 22(c)-5 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, relating to "inventories by dealers in securities." This Article states that taxpayers who buy and sell or hold securities for investment or speculation are not dealers in securities "within the meaning of this rule," irrespective of whether such buying or selling constitutes the carrying on of a trade or business.

While the problem is obscure, we doubt the relevancy of the regulation. The question before us relates to the status of assets rather than to the status of the taxpayer. The regulation has to do merely with inventories of dealers in securities, and there is here no question of inventories. Section 117(b) is not concerned with securities alone, but deals with all "property"; and certainly securities are property. Like other species of property, they are elimi-

nated from the statutory definition of capital assets if they belong in the category of "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." The statute appears to speak for itself.[1] The decisions in Schafer v. Helvering, 299 U.S. 171, 57 S. Ct. 148, 81 L.Ed. 101; Vaughan v. Commissioner, 2 Cir., 85 F. 2d 497; and Trading Associates Corp. v. Magruder, 4 Cir., 112 F. 2d 779, relied on by the Commissioner, are not decisive of the point. The case of Commissioner v. Burnett, 5 Cir., 118 F. 2d 659, appears to support the view that the regulation is controlling.

However, as above indicated, the court found that the securities were held by the taxpayer primarily for sale to customers in the ordinary course of its business, and not for investment or speculation. While the case is a close one on its facts, we are not prepared to say that the finding is clearly erroneous. There is an element of investment as well as an unavoidable element of speculation in every business in which property, whether tangible or intangible, is regularly bought and sold. The "in-and-out" market hanger-on who buys and sells through brokers on margin is a typical example of the pure speculator in stocks. Cf. Commissioner v. Burnett, 5 Cir., 118 F. 2d 659. On the other hand, an investor is ordinarily thought to be a person who acquires property for the income it will yield rather than for the profit he hopes to obtain on a resale. Appellee appears to belong less in either of these categories than in the category of a dealer. While it dealt in intangibles associated in the popular mind with speculation or invest-

---

[1] Cf. decisions of this court in **Ehrman v. Commissioner,** 120 F. 2d 607, 610; **Commissioner v. Boeing,** 106 F. 2d 305; **Jackson v. United States,** 110 F. 2d 574; **Richards v. Commissioner,** 81 F. 2d 369, 106 A.L.R. 249; **Miller v. Commissioner,** 102 F. 2d 476.

ment, nevertheless it carried on a regular business roughly comparable with that of a dealer in hogs or cattle or town lots, finding its customers where it could. Compare cases cited in note 1.

If the situation here had been the other way around, that is to say, if the transactions had resulted in gains instead of losses, it would not be surprising to find the Commissioner occupying the position now championed by the taxpayer, and vice versa. So things are apt to go in the domain of tax litigation.

Our conclusion in these respects makes it unnecessary to consider other questions discussed by counsel.

Affirmed.

HANEY, Circuit Judge, did not participate in the consideration or decision of this case.

# SUPREME COURT OF THE UNITED STATES

No. 20.—October Term, 1955.

| | |
|---|---|
| Corn Products Refining Company, Petitioner, *v.* Commissioner of Internal Revenue. | On Writ of Certiorari to the United States Court of Appeals for the Second Circuit. |

[November 7, 1955.]

Mr. Justice Clark delivered the opinion of the Court.

This case concerns the tax treatment to be accorded certain transactions in commodity futures.[1] In the Tax Court, petitioner Corn Products Refining Company contended that its purchases and sales of corn futures in 1940 and 1942 were capital asset transactions under § 117 (a) of the Internal Revenue Code of 1939. It further contended that its futures transactions came within the "wash sales" provisions of § 118. The 1940 claim was disposed of on the ground that § 118 did not apply, but for the year 1942 both the Tax Court and the Court of Appeals for the Second Circuit, 215 F. 2d 513, held that the futures were not capital assets under § 117. We granted certiorari, 348 U. S. 911,[2] because of an asserted

[1] A commodity future is a contract to purchase some fixed amount of a commodity at a future date for a fixed price. Corn futures, involved in the present case, are in terms of some multiple of five thousand bushels to be delivered eleven months or less after the contract. Cf. Hoffman, Future Trading (1932), 118.

[2] The grant was limited to the following two questions:

"1. Are transactions in commodity futures, which are not 'true hedges' capital asset transactions and thus subject to the limitations of Section 117 of the Internal Revenue Code of 1939, or do the resulting gains and losses from such transactions give rise to ordinary income and ordinary deductions?

"2. Are commodity futures contracts 'securities' and thus subject to the 'wash sales' provisions of Section 118 of the Internal Revenue Code of 1939?"

conflict with holdings in the Courts of Appeal for the Third, Fifth, and Sixth Circuits.[3] Since we hold that these futures do not constitute capital assets in petitioner's hands, we do not reach the issue of whether the transactions were "wash sales."

Petitioner is a nationally known manufacturer of products made from grain corn. It manufactures starch, syrup, sugar, and their byproducts, feeds and oil. Its average yearly grind of raw corn during the period 1937 through 1942 varied from thirty-five to sixty million bushels. Most of its products were sold under contracts requiring shipment in thirty days at a set price or at market price on the date of delivery, whichever was lower. It permitted cancellation of such contracts, but from experience it could calculate with some accuracy future orders that would remain firm. While it also sold to a few customers on long-term contracts involving substantial orders, these had little effect on the transactions here involved.[4]

In 1934 and again in 1936 droughts in the corn belt caused a sharp increase in the price of spot corn. With a storage capacity of only 2,300,000 bushels of corn, a bare three weeks supply, Corn Products found itself unable to buy at a price which would permit its refined corn sugar, cerelose, to compete successfully with cane and beet sugar. To avoid a recurrence of this situation, petitioner, in 1937, began to establish a long position in corn futures "as a part of its corn buying program" and "as the most eco-

[3] *Makransky's Estate* v. *Commissioner*, 154 F. 2d 59 (C. A. 3d Cir.); *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F. 2d 772 (C. A. 5th Cir.); *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. 2d 33 (C. A. 6th Cir.).

[4] Petitioner had contracts with three consumers to furnish, for a period of ten years or more, large quantities of starch or feed. In January 1940, petitioner had sold 2,000,000 bags of corn sugar, delivery to be made several months in the future. Also, members of the canning industry on the Pacific Coast had contracts to purchase corn sugar for delivery in more than thirty days.

nomical method of obtaining an adequate supply of raw corn" without entailing the expenditure of large sums for additional storage facilities. At harvest time each year it would buy futures when the price appeared favorable. It would take delivery on such contracts as it found necessary to its manufacturing operations and sell the remainder in early summer if no shortage was imminent. If shortages appeared, however, it sold futures only as it bought spot corn for grinding.[5] In this manner it reached a balanced position with reference to any increase in spot corn prices. It made no effort to protect itself against a decline in prices.

In 1940 it netted a profit of $680,587.39 in corn futures, but in 1942 it suffered a loss of $109,969.38. In computing its tax liability Corn Products reported these figures as ordinary profit and loss from its manufacturing operations for the respective years. It now contends that its futures were "capital assets" under § 117 and gains and losses therefrom should have been treated as arising from the sale of a capital asset.[6] In support of this position it

---

[5] The dispositions of the corn futures during the period in dispute were as follows:

| | *Sales of futures thousand bushels* | *Delivery under futures thousand bushels* |
|---|---|---|
| 1938 | 17,400 | 4,975 |
| 1939 | 14,180 | 2,865 |
| 1940 | 14,595 | 250 |
| 1941 | 2,545 | 2,175 |
| 1942 | 5,695 | 4,460 |

[6] "(1) CAPITAL ASSETS.—The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l); . . . ."

claims that its futures trading was separate and apart from its manufacturing operations and that in its futures transactions it was acting as a "legitimate capitalist," *United States* v. *New York Coffee & Sugar Exchange*, 263 U. S. 611, 619. It denies that its futures transactions were "hedges" or "speculative" dealings as covered by the ruling of General Counsel Memorandum 17322, XV–2 Cum. Bull. 151, and claims that it is in truth "the forgotten man" of that administrative interpretation.

Both the Tax Court and the Court of Appeals found petitioner's futures transactions to be an integral part of its business designed to protect its manufacturing operations against a price increase in its principal raw material and to assure a ready supply for future manufacturing requirements. Corn Products does not level a direct attack on these two-court findings but insists that its futures were "property" entitled to capital asset treatment under § 117 and as such were distinct from its manufacturing business. We cannot agree.

We find nothing in this record to support the contention that Corn Products' futures activity was separate and apart from its manufacturing operation. On the contrary, it appears that the transactions were vitally important to the company's business as a form of insurance against increases in the price of raw corn. Not only were the purchases initiated for just this reason, but the petitioner's sales policy, selling in the future at a fixed price or less, continued to leave it exceedingly vulnerable to rises in the price of corn. Further, the purchase of corn futures assured the company a source of supply which was admittedly cheaper than constructing additional storage facilities for raw corn. Under these facts it is difficult to imagine a program more closely geared to a company's manufacturing enterprise or more important to its successful operation.

Likewise the claim of Corn Products that it was dealing in the market as a "legitimate capitalist" lacks sup-

port in the record. There can be no quarrel with a manufacturer's desire to protect itself against increasing costs of raw materials. Transactions which provide such protection are considered a legitimate form of insurance. *United States* v. *New York Coffee & Sugar Exchange*, 263 U. S., at 619; *Browne* v. *Thorn*, 260 U. S. 137, 139–140. However, in labeling its activity as that of the "legitimate capitalist" exercising "good judgment" in the futures market, petitioner ignores the testimony of its own officers that in entering that market the company was "trying to protect a part of [its] manufacturing costs;" that its entry was not for the purpose of "speculating and buying and selling corn futures" but to fill an actual "need for the quantity of corn [bought] . . . in order to cover . . . what [products] we expected to market over a period of fifteen or eighteen months." It matters not whether the label be that of "legitimate capitalist" or "speculator"; this is not the talk of the capital investor but of the far-sighted manufacturer. For tax purposes petitioner's purchases have been found to "constitute an integral part of its manufacturing business" by both the Tax Court and the Court of Appeals, and on essentially factual questions the findings of two courts should not ordinarily be disturbed. *Comstock* v. *Group of Investors*, 335 U. S. 211, 214.

Petitioner also makes much of the conclusion by both the Tax Court and the Court of Appeals that its transactions did not constitute "true hedging." It is true that Corn Products did not secure complete protection from its market operations. Under its sales policy petitioner could not guard against a fall in prices. It is clear, however, that petitioner feared the possibility of a price rise more than that of a price decline. It therefore purchased partial insurance against its principal risk, and hoped to retain sufficient flexibility to avoid serious losses on a declining market.

Nor can we find support for petitioner's contention that hedging is not within the exclusions of § 117 (a). Admittedly, petitioner's corn futures do not come within the literal language of the exclusions set out in that section. They were not stock in trade, actual inventory, property held for sale to customers or depreciable property used in a trade or business. But the capital asset provision of § 117 must not be so broadly applied as to defeat rather than further the purpose of Congress. *Burnet* v. *Harmel*, 287 U. S. 103, 108. Congress intended that profits and losses arising from the every-day operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by § 117 applies to transactions in property which are not the normal source of business income. It was intended "to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions." *Burnet* v. *Harmel*, 287 U. S., at 106. Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose. This Court has always construed narrowly the term "capital assets" in § 117. See *Hort* v. *Commissioner*, 313 U. S. 28, 31; *Kieselbach* v. *Commissioner*, 317 U. S. 399, 403.

The problem of the appropriate tax treatment of hedging transactions first arose under the 1934 Tax Code revision.[7] Thereafter the Treasury issued GCM 17322,

[7] Section 208 (8) of the Revenue Act of 1924 limited "capital assets" to property held more than two years. This definition was retained until the Act of 1934. Since the rules of the various commodity exchanges required that futures contracts be closed out in periods shorter than two years, these contracts could not qualify as capital assets.

*supra*, distinguishing speculative transactions in commodity futures from hedging transactions. It held that hedging transactions were essentially to be regarded as insurance rather than a dealing in capital assets and that gains and losses therefrom were ordinary business gains and losses. The interpretation outlined in this memorandum has been consistently followed by the courts as well as the Commissioner.[8] While it is true that this Court has not passed on its validity it has been well recognized for 20 years, and Congress has made no change in it though the Code has been re-enacted on three subsequent occasions. This bespeaks congressional approval. *Helvering* v. *Winmill*, 305 U. S. 79, 83. Furthermore, Congress has since specifically recognized the hedging exception here under consideration in the short sale rule of § 1233 (a) of the 1954 Code.[9]

We believe that the statute clearly refutes the contention of Corn Products. Moreover, it is significant to note that

---

[8] *Stewart Silk Corp.* v. *Commissioner*, 9 T. C. 174; *Battelle* v. *Commissioner*, 47 B. T. A. 117; *Grote* v. *Commissioner*, 41 B. T. A. 247. See *Estate of Makransky* v. *Commissioner*, 5 T. C. 397, 412, aff'd *per curiam*, 154 F. 2d 59; *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. 2d 33, 35; *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F. 2d 772, 774; *Tennessee Egg Co.* v. *Commissioner*, 47 B. T. A. 558, 560; G. C. M. 18383, 1937–2 Cum. Bull. 244, 245; I. T. 3137, 1937–2 Cum. Bull. 164, 166. Cf. *Commissioner* v. *Banfield*, 122 F. 2d 1017, 1019–1020; G. C. M. 18658, 1937–2 Cum. Bull. 77.

[9] Section 1233 (a) provides that gain or loss from "the short sale of property, other than a hedging transaction in commodity futures," shall be treated as gain or loss from the sale of a capital asset to the extent "that the property, including a commodity future, used to close the short sale constitutes a capital asset in the hands of a taxpayer." The legislative history recognizes explicitly the hedging exception. H. R. Rep. No. 1337, 83d Cong., 2d Sess., p. A278; S. Rep. No. 1622, 83d Cong., 2d Sess., p. 437: "Under existing law bona fide hedging transactions do not result in capital gains or losses. This result is based upon case law and regulations. To continue this result hedging transactions in commodity futures have been specifically excepted from the operation of this subsection."

practical considerations lead to the same conclusion. To hold otherwise would permit those engaged in hedging transactions to transmute ordinary income into capital gain at will. The hedger may either sell the future and purchase in the spot market or take delivery under the future contract itself. But if a sale of the future created a capital transaction while delivery of the commodity under the same future did not, a loophole in the statute would be created and the purpose of Congress frustrated.

The judgment is

*Affirmed.*

MR. JUSTICE HARLAN took no part in the consideration or decision of this case.

# INDEX


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Question presented | 2 |
| Statute involved | 2 |
| Statement | 2 |
| Argument | 4 |
| Conclusion | 9 |


## CITATIONS


| | |
|---|---|
| Cases: | |
| *Burnett* v. *Commissioner*, 40 B. T. A. 605, affirmed in part, 118 F. 2d 659 | 6 |
| *Commissioner* v. *Covington*, 120 F. 2d 768, certiorari denied, 315 U. S. 822 | 7 |
| *Commissioner* v. *Stevens*, 78 F. 2d 713 | 7 |
| *Corn Products Refining Co.* v. *Commissioner*, 215 F. 2d 513, affirmed, 350 U. S. 46 | 7, 8 |
| *Kemon* v. *Commissioner*, 16 T. C. 1026 | 6 |
| *Polachek* v. *Commissioner*, 22 T. C. 858 | 6 |
| *Schafer* v. *Helvering*, 83 F. 2d 317, affirmed, 299 U. S. 171 | 7 |
| *Stokes* v. *Rothensies*, 61 F. Supp. 444, affirmed, 154 F. 2d 1022 | 8 |
| *United States* v. *Chinook Inv. Co.*, 136 F. 2d 984 | 7 |
| Statutes: | |
| Internal Revenue Code of 1939, Sec. 117 (a) (26 U. S. C. 1952 ed., Sec. 117 (a)) | 2, 4 |
| National Industrial Recovery Act, c. 90, 48 Stat. 195, 209, Sec. 218 (b) | 5 |
| Revenue Act of 1932, c. 209, 47 Stat. 169: | |
| Sec. 23 (r) | 5 |
| Sec. 101 (c) | 4 |
| Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 117 (b) | 5 |

Miscellaneous: Page

Baer and Saxon, *Commodity Exchanges and Future Trading* ..... 6

Hoffman, *Future Trading Upon Organized Commodity Markets in the United States* ..... 6, 7

H. Conference Rep. No. 1385, 73d Cong., 2d Sess., p. 22 (1939–1 Cum. Bull. (Part 2) 627, 632) ..... 5

H. Rep. No. 708, 72d Cong., 1st Sess., pp. 12–13 (1939–1 Cum. Bull. (Part 2) 457, 465–466) ..... 5

Irwin, *Evolution of Futures Trading* ..... 6

Miller, *The "Capital Asset" Concept*, 59 Yale L. J. 837, 844 (1950) ..... 5

Preliminary Report of Subcommittee of the Committee on Ways and Means: *Prevention of Tax Avoidance*, 73d Cong., 2d Sess., House Committee Print ..... 5

S. Rep. No. 1455, 73d Cong., 2d Sess., pp 29, 321 ..... 5, 6

United States Securities and Exchange Commissioner's Report on the Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker (1936) ..... 6

# In the Supreme Court of the United States

OCTOBER TERM, 1956

---

No. 156

ELSIE W. FAROLL, EXECUTOR OF THE ESTATE OF BARNETT FAROLL, DECEASED, PETITIONER

*v.*

JOHN T. JARECKI, COLLECTOR OF INTERNAL REVENUE

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT*

---

## BRIEF FOR THE RESPONDENT IN OPPOSITION

---

### OPINIONS BELOW

The District Court's findings of fact and conclusions of law (R. 39–43) and its memorandum opinion (R. 36–39) are unreported. The opinion of the Court of Appeals (Pet. 17–29) is reported at 231 F. 2d 281.

### JURISDICTION

The judgment of the Court of Appeals reversing the District Court's decision in favor of the taxpayer was entered on March 15, 1956. Taxpayer's petition for a writ of certiorari was filed on June 11, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

### QUESTION PRESENTED

Trading exclusively for his own account, taxpayer, a member of the Chicago Board of Trade, suffered losses from transactions in commodity futures. The question presented is whether these losses are ordinary business losses (as taxpayer contends) or capital losses (as contended by the Government and as held by the Court of Appeals).

### STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, * * *.

* * * * *

(26 U. S. C. 1952 ed., Sec. 117.)

### STATEMENT

The pertinent facts, as stipulated, are as follows:

Throughout the taxable year 1943, as for many years prior and subsequent thereto, the taxpayer was engaged in two distinct and separate activities, as follows: (1) He was a general partner (70 percent interest) in the brokerage firm of Faroll Brothers,

member of the Chicago Board of Trade Clearing Corporation; and (2) he was, as an independent member of the Chicago Board of Trade, engaged as a principal in the purchase and sale of commodity futures for his own account. The transactions involved in the instant case were not those regularly conducted by the firm for its customers in the ordinary course of its business. The taxpayer was personally present on the floor of the Exchange on each day it was open, during all the hours it was open, for the sole purpose of buying and selling commodity futures on his own behalf. (R. 16, 19, 41.) During 1943 the taxpayer, in more than 10,000 separate transactions, personally bought and sold, as principal on his own account, commodity futures involving almost 81,000,000 bushels, averaging, at a minimum, 41 separate transactions or over 325,000 bushels of grain per day. The taxpayer did not buy or sell commodity futures as hedges, nor was he at any time a farmer, producer, miller, operator of a grain elevator or warehouse, or a processor in any manner in grains. Nor did taxpayer specialize in trading any particular grain, his trading consisting of transactions in wheat, oats, rye, barley, corn and soybeans. The taxpayer made all of his purchases from other members of the Exchange and all of his sales to other members of the Exchange. (R. 17–18, 35, 42.) The taxpayer's purchases and sales were personally recorded by him on sheets set aside by him and contained in the partnership books of Faroll Brothers. These sheets did not contain an inventory account as such, but merely showed the taxpayer's open positions at the close of the year. (R.

17.) When not on the floor of the Exchange, the taxpayer devoted his remaining working time to research and other activities related to his activities on the Exchange, and consulted with his partners concerning important managerial questions arising in the firm's brokerage business. (R. 17, 41.)

The District Court, relying on the fact that taxpayer's trading activity was frequent and continuous, characterized the commodity futures sold by taxpayer as property held primarily for sale to customers in the ordinary course of his trade or business. It held accordingly that his losses could be deducted in full as ordinary business losses. (R. 42.) The Court of Appeals reversed (one judge dissenting). It held, *inter alia,* that taxpayer's sales were not sales "to customers" within the meaning of Section 117 (a) (1) of the 1939 Code and that, therefore, losses resulting from the sales were capital losses and not ordinary business losses.

## ARGUMENT

1. In defining "capital assets," Section 117 (a) (1) excludes "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business * * * " (*supra,* p. 2). The Court of Appeals' view that taxpayer here does not come within the quoted language finds most emphatic support in the legislative history. The definition of capital assets appearing in the Revenue Act of 1932 (see Section 101 (c) (8), c. 209, 47 Stat. 169) did not include the words "to customers" and "ordinary." Those terms were added by the Revenue Act of 1934

(see Section 117 (b), c. 277, 48 Stat. 680) for the express purpose of making it "impossible to contend" that a "speculator trading on his own account is not subject to the provisions of Section 117." H. Conference Rep. No. 1385, 73d Cong., 2d Sess., p. 22 (1939–1 Cum. Bull. (Part 2) 627, 632).[1] Without change, they were carried forward into the 1939 Code.

In keeping with this history, the statute has been uniformly applied so as to grant capital gain taxation and to require capital loss deductions where the taxpayer buys and sells securities or contracts for his

[1] A Congressional desire to bring certain transactions within the capital gains provisions in order that losses incurred in these transactions could not be deducted from ordinary income was first prompted by the disclosure that prominent financial leaders paid no federal income tax during 1930, 1931, and 1932 because their losses on sales of securities offset their very substantial income from other sources. This resulted in adoption of a provision in the National Industrial Recovery Act (Section 218 (b), c. 90, 48 Stat. 195, 209, repealing Section 23 (r) (2) of the Revenue Act of 1932, c. 209, 47 Stat. 169, 183) which restricted the deduction of losses upon sales of securities when incurred by "traders or other taxpayers who buy and sell securities for investment or speculation, whether or not on their own account, and irrespective of whether such buying and selling constitutes the carrying on of a trade or business." The reasoning was that such a person was not "a merchant of securities * * * engaged in the purchase of securities at wholesale and their resale to customers." (H. Rep. No. 708, 72d Cong., 1st Sess., pp. 12–13 (1939–1 Cum. Bull. (Part 2) 457, 465–466).) Congress pursued the same purpose in amending the definition of "capital assets" in the Revenue Act of 1934. See S. Rep. No. 1455, 73d Cong., 2d Sess., pp. 29, 321, Committee on Banking and Currency, "Stock Exchange Practices," accompanying the Securities Exchange Act of 1934; Preliminary Report of Subcommittee of the Committee on Ways and Means, *Prevention of Tax Avoidance*, 73d Cong., 2d Sess., House Committee Print, Ex. C, p. 35. See, also, Miller, *The "Capital Asset" Concept*, 59 Yale L. J. 837, 844 (1950).

own account. *Polachek* v. *Commissioner*, 22 T. C. 858, 862; *Kemon* v. *Commissioner*, 16 T. C. 1026, 1032; *Burnett* v. *Commissioner*, 40 B. T. A. 605, affirmed in part, 118 F. 2d 659 (C. A. 5th). Traders in commodities futures have always been considered to be speculators where the purpose of the trading is not to insure against the hazard of fluctuations in price (*i. e.*, to "hedge") but to profit from fluctuations in the market.[2] It is likewise axiomatic that such speculative trading "plays no part in the mechanics of executing orders for customers." S. Rep. No. 1455, 73d Cong., 2d Sess., p. 29.[3]

---

[2] Hoffman, *Future Trading Upon Organized Commodity Markets in the United States*, p. 135; Baer and Saxon, *Commodity Exchanges and Futures Trading*, p. 54; Irwin, *Evolution of Futures Trading*, pp. 68, 82–83.

[3] The following description of the speculative trader's activities appears in the United States Securities and Exchange Commission's Report on the Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker (1936), p. 5:

"The floor trader primarily engages in the business of buying and selling securities for his own account on the floor of the exchange."

" * * * The floor trader has no contact with the public, extends no credit, and usually does not maintain an independent office. He is a professional speculator who deals in securities for quick profits. He constantly seeks opportunities for rapid turnover and he prefers to liquidate a position swiftly whether his trading shows a profit or a loss. His activities are seldom restricted to a particular security or group of securities and, unlike the specialist, he professes no responsibility for the maintenance of a fair and orderly market. He does not solicit brokerage business and his brokerage function is distinctly of minor importance. He has few personal customers but occasionally is entrusted with the execution of large orders by members or firms who desire to conceal their presence in the market. Generally, however, the floor

In the instant case, there can be no question that taxpayer's "futures transactions were on his own behalf and not for the account of the partnership of which he was a member or for any of the customers of said partnership" (Pet. 22). It is also indisputable that taxpayer "did not buy or sell commodity futures as hedges nor was the taxpayer a farmer, producer, miller, operator of a grain elevator or warehouse, or a processor in any other manner of grains" (Pet. 23). The record is also clear that petitioner was not a specialist in any particular commodity. Thus, on all the facts, the Court of Appeals correctly concluded that taxpayer cannot analogize his trading for his own account to merchandising for customers. See *Schafer* v. *Helvering*, 83 F. 2d 317, 319 (C. A. D. C.), affirmed, 299 U. S. 171; *Corn Products Refining Co.* v. *Commissioner*, 315 F. 2d 513 (C. A. 2d), affirmed, 350 U. S. 46; *Commissioner* v. *Covington*, 120 F. 2d 768 (C. A. 5th), certiorari denied, 315 U. S. 822. Cf. *Commissioner* v. *Stevens*, 78 F. 2d 713 (C. A. 2d).

2. There is no conflict between the instant decision and the Ninth Circuit's decision in *United States* v. *Chinook Inv. Co.*, 136 F. 2d 984, on which the taxpayer relies. In the *Chinook* case, the court stressed the fact that purchases "were often made direct from the owners of stock, and taxpayer was

---

trader prefers to remain independent. Hence, he is not restrained in his trading by the forces of competition for brokerage business or the necessity for retaining the good will of customers."

See also Hoffman, *op. cit.*, pp. 106–107.

frequently approached by brokers who had securities to buy or sell. Persons or concerns believed to be interested in making sales or purchases were solicited * * *. In the acquisition of securities, 'investment was not the idea of the company'" (*ibid.*). Unlike that situation, in which the analogy to ordinary merchandising was nearly complete, the entire record here establishes that the instant taxpayer was what the Ninth Circuit describes as an "'in-and-out' market hanger-on" and a "typical example of the pure speculator in stocks" (136 F. 2d at 985). It thus appears that on the facts of the case at bar the Ninth Circuit would have reached the identical result. Cf. *Stokes* v. *Rothensies*, 61 F. Supp. 444 (E. D. Pa.), affirmed, *per curiam*, 154 F. 2d 1022 (C. A. 3d).

It is also apparent that the decision below is not in conflict with *Corn Products Co.* v. *Commissioner*, 350 U. S. 46. In the *Corn Products* case, the taxpayer's operations in grain futures were "an integral part of its manufacturing business" (p. 51). As this Court stated (p. 52), Congress intended that the profits and losses resulting from the routine operations of a going business be treated as ordinary income or loss. The fact situation in the instant case bears no resemblance to that involved in *Corn Products* [illegible] and, as emphasized above, there was a specific Congressional purpose to make the capital gain and loss provisions applicable to the market speculator trading on his own account.

## CONCLUSION

The decision of the court below is correct and there is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted,

SIMON E. SOBELOFF,
*Solicitor General.*
CHARLES K. RICE,
*Assistant Attorney General.*
HILBERT P. ZARKY,
STANLEY P. WAGMAN,
*Attorneys.*

JULY 1956.

U. S. GOVERNMENT PRINTING OFFICE: 1956

FILED
AUG 3 1956
JOHN T. FEY, Clerk

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956.

## *No. 156*

Elsie W. Faroll, Executor of the Estate of Barnett Faroll, Deceased,

*Petitioner,*

*vs.*

John T. Jarecki, Collector of Internal Revenue,

*Respondent.*

**Petitioner's Reply to Respondent's Brief in Opposition.**

CLAUDE A. ROTH
SIDNEY U. HIKEN
BERNARD WEISBERG
231 S. LaSalle Street
Chicago 4, Illinois

JOSEPH H. TAYLOR
29 S. LaSalle Street
Chicago 3, Illinois
Counsel for Petitioner

GOTTLIEB and SCHWARTZ,
Of Counsel.

The Scheffer Press, Inc.—ANdover 3-6850

## Citations.


| | PAGE |
|---|---|
| U. S. v. Chinook Investment Company, 136 F. 2d 984 (C.A. 9, 1943) | 1, 4 |
| United States v. New York Coffee & Sugar Exchange, 263 U. S. 611 (1924) | 3 |
| Corn Products Refining Co. v. Commissioner, 350 U. S. 46 (1955) | 4 |

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1956.

---

**No. 156**

---

Elsie W. Faroll, Executor of the Estate of Barnett Faroll, Deceased,

*Petitioner,*

*vs.*

John T. Jarecki, Collector of Internal Revenue,

*Respondent.*

---

**Petitioner's Reply to Respondent's Brief in Opposition.**

---

The only point made in the Government's brief is that the respondent regards the decision below as correct because of the legislative background of the 1934 Amendment to the statutory definition of capital assets. This point is untenable for the following reasons:

1. The Government's position completely ignores the clear language of the statute and violates basic rules of statutory construction. If the Government's view is sustained, the statutory concept "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business" would be replaced by a distinction between "speculation" and "merchandising". But, as Judge Healy pointed out in *U. S.* v. *Chinook Investment Company*, 136 F. 2d 984, there is an element of

speculation in every business in which property is regularly bought and sold. In addition, property bought and sold by "merchants" was in 1934 already excluded from capital asset treatment because it falls within the statutory exclusion of "stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year." Section 117 (a) (1). Moreover, the "speculation" versus "merchandising" version of the statute is, as pointed out in the Petition, not argued by the Government in cases involving other types of property, notably real estate. Thus, the Government's interpretation would produce a statute which is in part vague, in part redundant, and in part internally inconsistent. Circuit Judge Lindley and District Judge Barnes, both of whom had the Government's version of this legislative history before them, held that the clear and natural meaning of "customers" includes the other Board of Trade members to whom the taxpayer sold commodity futures. Significantly, the majority of the Court of Appeals chose not to rest its decision on the Government's interpretation of this legislative history.

2. An examination of the legislative history shows clearly that Congress did not intend that the tax status of commodity futures transactions should be affected or altered by the 1934 Amendment to Section 117. The background of this amendment discloses that Congress was concerned about the use of certain tax avoidance devices in securities transactions, devices which find no parallel whatever in the business of this taxpayer or others similarly situated. The distinction between "speculation" and "merchandising" was itself drawn from regulations relating to the right of securities dealers to inventory securities bought for their own account. But this distinction,

assuming that it is meaningful when applied to securities dealers, makes no sense whatever when applied to commodity futures transactions since, unlike securities, it is impossible to merchandise commodity futures after the fashion of a corner grocer, *i.e.*, buying at wholesale for resale to others at a mark-up in price. Under the Commodity Exchange Act, it is in fact illegal to sell commodity futures outside of a regulated commodity exchange, 7 U.S.C.A. Sections 2, 6, 6e and 6h. Moreover, there are no "specialists" on commodity exchanges comparable to those found on securities exchanges. For this reason, the description of "floor traders" in Page 6, Note 3 of the respondent's brief, which actually relates to securities exchanges, is misleading when applied to persons who buy and sell commodity futures for their own account as exchange members, as did the taxpayer in this case.[1] Because of these differences between transactions in securities and transactions in commodity futures, the Government's argument means that, absent hedging, it is impossible as a matter of law to be a "dealer" in commodity futures or sell commodity futures to "customers." To torture this conclusion from an obscure legislative background serves only to emphasize the position of the petitioner—that there is a compelling need for this Court to clarify the general confusion and uncertainty relating to the interpretation of the statutory definition of capital assets insofar as it affects the continuing day-in and day-out buyer and seller of commodity futures.

---

[1] The texts cited by the respondent which classify all commodity futures transactions as "speculative" where hedging is not involved are no more relevant to the statutory question in this case than the labels in **United States v. New York Coffee & Sugar Exchange,** 263 U.S. 611, discussed at pages 11-12 of the Petition.

3. The Government's response begs what, under its own analysis, is a crucial question, namely, whether an individual who like this taxpayer devoted virtually all of his time to buying and selling commodity futures as an exchange member can be fairly characterized as the kind of "speculator" Congress had in mind in 1934. That he cannot be so characterized is manifest from the attempt of the Government to label him as an "'in-and-out' market hanger-on" and a "typical example of the pure speculator in stocks." It is nonsense to apply such labels to a taxpayer whose buying and selling was as frequent, continuous and extensive as the dealings disclosed in this record.

The Government's attempts to deny the conflict between the decision below and *U. S.* v. *Chinook Investment Company*, 136 F. 2d 984, and the *principles* stated in *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46, consist of no more than *ipse dixits*. However, they do illustrate vividly the impossibility of making any sense out of the "speculation" versus "merchandising" distinction as a guide to the interpretation of the statute in relation to commodity futures transactions.

As stated in the Petition, the decision below singles out an entire and economically significant class of taxpayers for discriminatory tax treatment which has no justification in the language of the statute, its background,

or common sense. The issue is of general importance and should be resolved by this Court.

Respectfully submitted,

CLAUDE A. ROTH
SIDNEY U. HIKEN
BERNARD WEISBERG
231 S. LaSalle Street
Chicago 4, Illinois

JOSEPH H. TAYLOR
29 S. LaSalle Street
Chicago 3, Illinois
*Counsel for Petitioner*

GOTTLIEB AND SCHWARTZ,
*Of Counsel.*

Dated August 2....., 1956.